CONSOLIDATED CANADIAN FARADAY LIMITED

1977 ANNUAL REPORT

CONSOLIDATED CANADIAN FARADAY LIMITED

Directors:	W. Clarke Campbell, Member of the firm of Day, Wilson, Campbell, Barristers and Solicitors.
	Martin P. Connell, President and Chief Executive Officer, Conwest Exploration Company Limited.
	John C. Lamacraft, President, International Mogul Mines Limited
	Jules Loeb, General Manager, Falcon Investments Limited.
	Howard A. Masson, Mining Executive.
	C. Kelly O'Connor, Vice-President Exploration and Development, Conwest Exploration Company Limited.
	Archibald B. Whitelaw, Q.C. Barrister and Solicitor.
Officers:	W. Clarke Campbell, President.
	Martin P. Connell, Executive Vice-President.
	C. Kelly O'Connor, Vice-President, Exploration.
	William M. O'Shaughnessy, Secretary-Treasurer.
Registrar and Transfer Agent:	Guaranty Trust Company of Canada Toronto
Co-Transfer Agent:	Bank of Montreal Trust Company New York, N.Y.
Auditors:	Thorne Riddell & Co. Toronto, Ontario
Head Office:	10th Floor, 85 Richmond Street West, Toronto, Ontario

TO THE SHAREHOLDERS

Your directors are pleased to present the annual report for the year ended December 31, 1977. Included are the consolidated financial statements of the Company, the auditors' report and the financial statements of Madawaska Mines Limited for the fiscal period ending on that date. Also enclosed are notice of annual meeting, information circular, proxy statement and form of proxy.

Mineral Operations

Madawaska Mines Limited, in which your Company has a 49% interest, maintained continuous production during 1977. From 295,068 tons of ore milled, 440,753 pounds of U_3O_8 were produced. The price received for production during the year was $32.20 per pound of U_3O_8, a price determined as the 'world market value' for 1977 delivery by F. M. Ticehurst, an expert selected under the sales agreement to make such determination. The Atomic Energy Control Board has ruled that export permits covering 1977 production will not be issued unless a price of not less than $42.00 per pound is paid. Active negotiations are in progress at time of writing which should lead to resolution of the price impasse to the financial benefit of Madawaska.

Petroleum and Natural Gas Interests

In February, 1977, the petroleum properties of I.E.C. Energy of Kentucky were sold to an unaffiliated group for $175,000 U.S.

On the gas leases in the Redcliffe area of Alberta, in which your Company has 11% interest, an additional eleven wells were drilled and tied into the gathering system during 1977.

Exploration

The holdings of Hydra Explorations Limited and Massval Mines Limited, companies in which your Company has a substantial interest, were maintained in good standing. No direct exploration work was performed by these companies in the year under review. Substantial work was performed in Hydra's Nighthawk Lake property by Pamour Porcupine Mines Limited which has a production option on the property.

The interest in the Greenarctic Consortium has been maintained. During the year the Consortium reported no significant activity.

Participation in two exploration programs managed by Conwest Exploration Company Limited was continued. In the general mineral exploration program your Company has a 25% interest and a 5% interest in the five-year uranium joint venture. No significant mineral deposits were discovered in 1977, although a number of promising prospects were and are being investigated.

Other Interest, Lines of Business

In Fort Myers, Florida, your Company continues to operate a 51-suite apartment complex.

Percentage of revenue for lines of business for each of the past two fiscal years are as follows:

	1977	1976
	%	
Mineral Operations	—	18
Oil and gas interests	22	35
Real estate and investment income	78	47

Management Discussion and Analysis

Since the Company discontinued milling operations in mid 1976, there has been a slight decrease in revenue, resulting from curtailment of the management fee which the Company was receiving from the operation. Current sources of revenue are interest on bank deposit receipts, rental income from the apartment complex, and income from natural gas interests. In addition, during 1977 there was a modest return from the sale of mining and milling machinery from the Werner Lake and Dumbarton plants. Operating expenses were markedly decreased in 1977 and 1976 as a result of the termination of concentrator operations.

The increase in outside exploration expenses for 1976 and 1977 is a result of the Company's participation in the two exploration programs managed by Conwest.

In 1977, the investment in Prairie Potash Mines Limited, having a book value of $180,000, was written down to nominal value, thus contributing to the loss for the year. Partly offsetting this was extraordinary income received from the sale of shares of I.E.C. Energy of Kentucky Inc.

Similarly, in 1975 the sale of shares of Intercontinental Energy Corporation, together with the receipt of a uranium contract agency fee, contributed to the income picture.

Price Range of Common Shares

	1977	1976
First Quarter	$3.75 - 2.90	$3.85 - 2.50
Second Quarter .	3.75 - 2.85	4.40 - 3.50
Third Quarter ...	3.75 - 2.60	4.15 - 3.40
Fourth Quarter ..	3.05 - 2.25	3.65 - 2.40

For the past two fiscal years the company has paid no dividends on its common stock.

Copies of the Company's Form 10-K report to the Securities and Exchange Commission are available without charge upon request. Please write: Secretary, Consolidated Canadian Faraday Limited, 10th Floor, 85 Richmond Street West, Toronto, Ontario, M5H 2G1.

On Behalf of the Board,

W. C. Campbell

W. CLARKE CAMPBELL,
President.

Toronto, Ontario,
May 31, 1978.

CONSOLIDATED CANADIAN FARADAY LIMITED
(Incorporated under the laws of Ontario)

CONSOLIDATED BALANCE SHEET
AS AT DECEMBER 31, 1977 AND 1976

ASSETS

CURRENT ASSETS	1977	1976
Cash and short-term deposits	$ 779,888	$1,673,326
Short term deposits held in cash collateral account (note 6(b))	1,000,000	
Accounts receivable	65,136	214,177
Prepaid expenses	7,772	18,730
	1,852,796	1,906,233
INVESTMENTS (notes 2 and 3)		
Shares in and advances to effectively controlled companies	308,183	306,983
Investment in other companies	246,100	435,528
	654,283	742,511
FIXED ASSETS		
Land, buildings, plant and equipment, at cost	802,715	787,875
Less accumulated depreciation	273,285	252,679
	529,430	535,196
Mining claims, rights, properties and leases, at cost	392,401	392,401
Interest in petroleum and natural gas leases, at cost less depletion (note 4)	70,378	162,056
	992,209	1,089,653
OTHER ASSETS		
Mine equipment and supplies, at written down value (note 5)		60,000
Loan costs less amortization	10,827	12,053
Mortgage receivable	17,264	19,264
	28,091	91,317
	$3,427,379	$3,829,714

Approved by the Board:

J. C. LAMACRAFT, Director.

W. C. CAMPBELL, Director.

LIABILITIES

CURRENT LIABILITIES	1977	1976
Accounts payable and accrued liabilities	$ 94,502	$ 148,560
Current portion of long-term debt	9,492	8,430
	103,994	156,990
LONG-TERM DEBT		
Petroleum production and other payments (note 4)		58,627
10% Mortgage payable $3,999 U.S. monthly including principal and interest, maturing November 1, 1986	369,804	379,685
	369,804	438,312

SHAREHOLDERS' EQUITY

CAPITAL STOCK		
Authorized — 5,000,000 shares of no par value		
Issued — 3,558,800 shares	6,665,997	6,665,997
CONTRIBUTED SURPLUS	1,506,061	1,506,061
	8,172,058	8,172,058
DEFICIT	5,218,477	4,937,646
	2,953,581	3,234,412
	$3,427,379	$3,829,714

Commitments and contingencies (note 6)

AUDITORS' REPORT

To the Shareholders of Consolidated Canadian Faraday Limited

We have examined the consolidated balance sheet of Consolidated Canadian Faraday Limited as at December 31, 1977 and 1976 and the consolidated statements of income, deficit and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1977 and 1976 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles applied on a consistent basis.

Toronto, Canada
June 1, 1978

THORNE RIDDELL & CO.
Chartered Accountants

CONSOLIDATED STATEMENT OF INCOME
YEARS ENDED DECEMBER 31, 1977 AND 1976

	1977	1976
Rental and other income	$ 272,074	$ 324,891
Income from petroleum and natural gas properties	77,399	172,887
	349,473	497,778
Operating expenses (including interest of $42,058; 1976, $8,419)	302,419	456,992
	47,054	40,786
Depreciation and depletion	24,946	160,898
	22,108	120,112
Outside exploration	300,729	250,676
Provision for decline (increase) in value of investments (note 2(d))	173,949	(169,122)
	474,678	81,554
Income of effectively controlled companies	17,474	37,350
Gain on cessation of mining operations	34,612	22,603
	52,086	59,953
	422,592	21,601
Loss before undernoted items	400,484	141,713
Gain on sale of shares of subsidiary	116,801	
Income taxes of subsidiary	2,852	(512)
	119,653	(512)
LOSS FOR THE YEAR	$ 280,831	$ 142,225
LOSS PER SHARE	8¢	4¢

CONSOLIDATED STATEMENT OF DEFICIT
YEARS ENDED DECEMBER 31, 1977 AND 1976

	1977	1976
DEFICIT AT BEGINNING OF YEAR	$4,937,646	$4,795,421
Loss for the year	280,831	142,225
DEFICIT AT END OF YEAR	$5,218,477	$4,937,646

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

YEARS ENDED DECEMBER 31, 1977 AND 1976

	1977	1976
WORKING CAPITAL DERIVED FROM		
Mortgage payable		$ 389,916
Reclassification of advances receivable		124,660
Reduction of advances to Dumbarton Mines Limited, net	$ 31,753	75,560
Proceeds from sale of shares of subsidiary less its working capital of $9,910	170,377	
Sale of mine equipment and supplies	60,000	228,369
Reduction of mortgage receivable	2,000	2,000
	264,130	820,505
WORKING CAPITAL APPLIED TO		
Operations		
Loss for the year	280,831	142,225
Items not involving working capital	(65,453)	44,762
	215,378	186,987
Purchase of investments		6,000
Additions to land, buildings, plant and equipment	14,840	149,332
Loan costs		12,896
Reduction of long-term debt	9,881	48,845
Purchase of and additions to interest in petroleum and natural gas leases	24,472	22,622
	264,571	426,682
INCREASE (DECREASE) IN WORKING CAPITAL	(441)	393,823
WORKING CAPITAL AT BEGINNING OF YEAR	1,749,243	1,355,420
WORKING CAPITAL AT END OF YEAR	$1,748,802	$1,749,243

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 1977 AND 1976

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

(a) Basis of consolidation

These financial statements include the accounts of the following wholly-owned subsidiary companies: Bancroft Holdings Limited, I.E.C. Energy of Kentucky, Inc., (sold in 1977, note 4), Farida, Inc., and Faramines, Inc.

(b) Investments

Effectively controlled companies

These investments are carried on a basis of accounting which reflect changes in equity since January 1, 1973.

Other companies

Investments are carried at not in excess of cost.

(c) Fixed assets

Cost

(i) Land, buildings, plant and equipment

All land, buildings, plant and equipment are stated at cost.

(ii) Mining properties

Mining properties are recorded at cost. When the properties are considered to be permanently uneconomical they are written off.

Depreciation and depletion

(i) Depreciation

Buildings, plant and equipment, consisting mainly of the Florida real estate operation of Farida, Inc., are being depreciated on a straight line basis over their estimated useful life.

(ii) Depletion

At December 31, 1977 mining claims, rights, properties and leases of $392,401 have been deferred with the intention that they should be amortized by charges against income from future operations. The recovery of these costs is dependent, therefore, upon the development of economic operations. The applicable cost of participation in petroleum and natural gas projects is being amortized against related income from operations (note 4).

(d) Exploration and development expenditures

Exploration and development expenditures relating to producing properties are written off as incurred. Development expenditures on non-producing properties are deferred until production commences or the property is considered to be permanently uneconomical. When production commences, these expenditures are then written off over the expected remaining life of the mine. When a property is considered to be permanently uneconomical the related development expenditures are written off.
General outside exploration is written off as incurred.

(e) Foreign exchange

Amounts in foreign currency have been translated into Canadian dollars on the following bases:

(i) Current assets and current liabilities at the rate of exchange in effect as at the balance sheet date

(ii) Fixed assets, related depreciation and long-term debt at historical rates

(iii) Revenues and expenses at the average rate of exchange in effect during the year.

2. **INVESTMENTS**

(a) Investment in effectively controlled companies

	Dumbarton Mines Limited (note 5)	Hydra Explorations Limited	Massval Mines Limited	Total
Percentage ownership	50%	36%	44%	
Balance at January 1, 1976	Nil	$ 157,179	$ 147,954	$ 305,133
Changes during 1976				
Share of income	$ 35,500	1,850		37,350
	35,500	159,029	147,954	342,483
Increase in allowance for decline in value (note 2(d))	40,060			40,060
Reduction of advances (net)	(75,560)			(75,560)
Balance at December 31, 1976	Nil	159,029	147,954	306,983
Changes during 1977				
Share of income	16,274	1,200		17,474
Decrease in allowance for decline in value (note 2(d))	15,479			15,479
Reduction of advances (net)	(31,753)			(31,753)
Balance at December 31, 1977	Nil	$ 160,229	$ 147,954	$ 308,183

Included in the shares of Massval Mines Limited are 691,037 escrowed shares.

(b) Investment in other companies, not in excess of cost

	1977	1976
Shares in other companies (quoted market value 1977, $39,600; 1976, $49,000)	$ 39,576	$ 49,005
Shares and debenture of Madawaska Mines Limited (note 3)	21,023	21,023
Shares of Prairie Potash Mines Limited	1	180,000
Shares and convertible debenture of Caledonia Resources Limited (formerly Henrietta Mines Limited)	185,500	185,500
	$ 246,100	$ 435,528

During 1977 the operator and principal shareholder of Prairier Potash Mines Limited decided to allow approximately one half of that company's potash leases to lapse and in view of that and the continuing uncertainty of demand for the product the investment has been written down to nominal value.

Realization on the investment in Caledonia Resources Limited is dependent upon successful financing and commercial exploitation of its resource interests.

Included in the quoted market value is $1,890 ($5,250 in 1976) representing escrowed shares which have been valued at 50% of the quoted market value of free shares.

(c) Investment in companies for which there is a quoted market value includes instances of large shareholdings where quoted market values are not necessarily indicative of amounts which might be realized if the shares were to be sold.

(d) Provision for decline (increase) in value of investments provided during the year is made up as follows:

	1977	1976
Prairie Potash Mines Limited	$ 180,000	
Dumbarton Mines Limited	(15,479)	$ (40,060)
Other investments	9,428	(129,062)
	$ 173,949	$ (169,122)

3. **MADAWASKA MINES LIMITED (BANCROFT, ONTARIO)**

During 1975, pursuant to the terms of an agreement with Federal Resources Corporation dated September 8, 1966, as amended, the Company transferred its Bancroft (uranium) property to Madawaska Mines Limited (Madawaska) for a 49% interest therein. Such interest consists of 490 of the 1,000 issued shares of Madawaska and a $1,000,000 debenture payable out of net cash flow as defined in the agreement.

This investment is carried at the net book value of the Company's Bancroft assets contributed. In prior years depreciation of $6,234,333 and depletion of $409,609 had been provided in respect thereof. The Company has assisted Madawaska by providing collateral security of $1,000,000 in respect of bank indebtedness (see note 6(b)).

4. **INTEREST IN PETROLEUM AND NATURAL GAS LEASES**

Details of interests held are as follows:

	1977	1976
Participation in drilling of wells on Faraday's approximately 11% interest in certain natural gas leases in the Redcliffe area of southeastern Alberta	$ 78,890	$ 54,419
Less depletion	8,512	4,567
	70,378	49,852
Petroleum and natural gas leases held by I.E.C. Energy of Kentucky, Inc. Kentucky, U.S.A.		709,352
Less depletion		597,148
		112,204
	$ 70,378	$ 162,056
The properties held in Kentucky, U.S.A. give rise to the following liabilities: Petroleum production payments (to be paid out of proceeds from production)		$ 58,627

During 1977 all of the issued and outstanding shares of I.E.C. Energy of Kentucky, Inc. were sold for $175,000 U.S.

5. **WERNER AND BIRD LAKE OPERATIONS**

The economic life of the orebody of Dumbarton Mines Limited (Dumbarton) ended in December, 1974 and up to January 31, 1975 the Company used the Dumbarton facility to gain access to and crush ore from an adjacent property leased by it directly from Maskwa Nickel Chrome Mines Limited (Maskwa) (a subsidiary company of Falconbridge Nickel Mines Limited) (Falconbridge).

As of February 1, 1975, the Company ceased mining and milling ore from the property of Maskwa for its own account and entered into a new arrangement whereby the economic risk of the operation was assumed by Falconbridge and through Dumbarton, the Company became operator of the venture at a fixed fee based primarily on tonnage mined and milled. As part of this arrangement the milling facilities and infrastructure at Werner Lake were leased to Dumbarton with an option to purchase.

Falconbridge terminated the lease effective June 30, 1976 and as of that date all mining operations ceased. The option to purchase was similarly terminated.

As provided for in the agreement, the Company settled all liabilities outstanding at January 31, 1975 including liabilities for Manitoba Mining Tax arising as a result of operations to that date. All moveable machinery, equipment and supplies of Dumbarton were transferred to the Company at a value acceptable to Maskwa and the indebtedness of Dumbarton was accordingly reduced. Proceeds from subsequent disposals of buildings, plant and fixed equipment are similarly reducing the indebtedness.

With both operations having ceased, disposal of mining and milling assets has been carried out from July, 1976.

6. **COMMITMENTS AND CONTINGENCIES**

(a) Agreements, as amended, with Conwest Exploration Company Limited (Conwest) The Company participates in exploration programmes managed by Conwest as follows:

(i) A 25% participation in a mineral exploration programme for a period of three years commencing January 1, 1976 at a maximum annual cost to the Company of $375,000 subject to the Company's right to elect to participate further. In addition, the Company has agreed to reimburse its co-participants in the amount of $61,300 in the event of a commercial discovery upon certain of the lands under exploration.

(ii) A 5% participation in a uranium exploration programme. The Company's annual commitment during the primary stage is $75,000 for a total of $375,000 to December 31, 1980. Under the terms of the agreement the Company is entitled to receive 2½% of direct expenditures incurred and a gross royalty of ¾% of production being part of the management fee and gross royalty accruing to Conwest. If all expenditures contemplated under the primary phase are incurred the Company's portion of the management fee would be $187,500. The agreement provides for further participation if warranted by the results of the primary phase.

(b) Guarantees

Madawaska Mines Limited

On October 8, 1977 the Company placed in a cash collateral account $1,000,000 in bank deposit receipts to support bank indebtedness of Madawaska with its bankers. The Company shares in the bank's security from Madawaska subject to the bank's prior realization. While these funds remain in the collateral account, the Company will receive from Madawaska an interest fee at the rate of 2½%. The Company's bankers have stated that these funds will be released upon the receipt of monies payable to Madawaska by Madawaska's major customer as a condition precedent to the granting of export permits by the Atomic Energy Control Board. The dispute as to the export price of the uranium concentrate is under settlement negotiation. Management expects this matter will be resolved satisfactorily in the month of June, 1978, with the resultant release of the collateral funds.

Dumbarton Mines Limited

The company has guaranteed certain debts of Dumbarton Mines Limited (see note 5).

(c) Lease purchase option

During 1976 Farida, Inc. exercised its option to purchase the property on which its apartments are located for $150,000.

(d) Long term debt

The principal amount repayable in U.S. dollars in each of the next five years is as follows:

1978	$ 9,479	1981	$ 12,780
1979	10,472	1982	14,118
1980	11,568		

7. **OTHER STATUTORY INFORMATION**

Remuneration of directors and senior officers (as defined by the Business Corporations Act) amounts to $109,000 ($152,000 in 1976).

SUMMARY OF OPERATIONS

	1977	1976	1975	1974	1973
Revenues	$ 349,473	$ 497,778	$ 870,140	$ 1,276,488	$ 587,067
Operating expenses other than below	292,753	595,287	1,559,208	2,051,739	470,569
	56,720	(97,509)	(689,068)	(775,251)	116,498
Share of losses of effectively controlled companies	(17,474)	(37,350)	(26,388)	171,494	168,079
Outside exploration	300,729	250,676	85,056	67,096	128,423
Write-down of investment in and advance to other companies	173,949	(169,122)	157,919	215,968	157,181
Development expenditures			219,944	987,315	
	457,204	44,204	436,531	1,441,873	453,683
Income (loss) before undernoted items	(400,484)	(141,713)	(1,125,599)	(2,217,124)	(337,185)
Income from uranium contract agency and management fee			1,441,000		
Gain on sale of shares of subsidiary	116,801		80,584		
Income taxes of subsidiary	(2,852)	512	3,500	4,500	7,500
	119,653	512	1,518,084	4,500	7,500
NET INCOME (LOSS)	$ (280,831)	$ (142,225)	$ 392,485	$ (2,221,624)	$ (344,685)
EARNINGS (LOSS) PER SHARE	$ (.08)	$ (.04)	$.11	$ (.65)	$ (.10)
Common shares outstanding	3,558,800	3,558,800	3,558,800	3,421,300	3,421,300

MADAWASKA MINES LIMITED

STATEMENTS OF FINANCIAL POSITION

ASSETS

	December 31 1977	1976
CURRENT ASSETS		
Cash	$ 300,600	$ 74,960
Accounts receivable — Note B	4,262,298	1,748,164
Inventories:		
Materials and supplies	748,118	494,942
Broken ore inventory	885,078	115,872
Concentrate in process	158,815	158,815
	1,792,011	769,629
Prepaid expenses and other current assets	74,224	21,905
TOTAL CURRENT ASSETS	6,429,133	2,614,658
PROPERTY, PLANT, AND EQUIPMENT		
Land, mining claims, and leases	2,521,541	2,518,428
Buildings	2,202,585	1,596,408
Equipment	4,131,542	2,713,015
Construction in progress	1,262,173	659,108
	10,117,841	8,486,959
Less allowances for depreciation and depletion	1,009,163	261,180
	9,108,678	8,225,779
DEFERRED CHARGES — Note C		
Organization costs, less amortization of $7,779 in 1977 and $2,476 in 1976	57,143	62,446
Management fee, less amortization of $46,431 in 1977 and $13,614 in 1976	353,569	386,386
Agency contract, less amortization of $429,774 in 1977 and $144,804 in 1976	3,070,226	3,355,196
Deferred mine development costs, less amortization of $605,430 in 1977 and $180,696 in 1976	6,063,406	5,000,747
	9,544,344	8,804,775
	$25,082,155	$19,645,212

See notes to financial statements

LIABILITIES AND SHAREHOLDERS' EQUITY

	December 31 1977	1976
CURRENT LIABILITIES		
Note payable to bank	$ 2,150,000	$ 1,850,000
Bank advances	1,001,456	445,607
Trade accounts payable	673,564	348,940
Accounts payable to Federal Resources Corporation	365,278	61,882
Other payable and accrued liabilities	1,030,058	583,094
Mining taxes	655,000	13,000
Current portion of long-term debt	1,007,795	1,006,282
TOTAL CURRENT LIABILITIES	6,883,151	4,308,805
LONG-TERM DEBT		
Indebtedness to shareholders — Note E	4,999,039	2,831,712
Note payable to bank, interest at prime rate plus 1½%, payable in minimum annual installments of the greater of $1,000,000 or 75% of the net cash flow, beginning October 1, 1977, less current portion of $1,000,000 in 1977 and $1,000,000 in 1976 — Note F	4,100,000	5,100,000
Notes payable, interest rates from 10½% to 13½% collateralized by mortgages on houses and trailers costing $399,688 in 1977 and $264,040 in 1976, less current portion of $7,795 in 1977 and $6,282 in 1976	385,139	246,880
	9,484,178	8,178,592
DEFERRED INCOME — Note G	—	3,900,000
DEFERRED INCOME TAXES — Note A	1,310,000	45,000
SHAREHOLDERS' EQUITY		
Common Stock, no par value: Authorized, issued and outstanding 1,000 shares	3,000,000	3,000,000
Retained earnings	4,404,826	212,815
	7,404,826	3,212,815
	$25,082,155	$19,645,212

Approved on behalf of the Board:

N. W. STALHEIM, Director.

J. W. LOSSE, Director.

STATEMENTS OF EARNINGS AND RETAINED EARNINGS

Year Ended December 31, 1977, and Four Months Ended December 31, 1976

	1977	1976
Revenues:		
Concentrate sales, net — Note B	$17,499,632	$ 3,180,758
Other income	70,905	7,356
	17,570,537	3,188,114
Cost and expenses:		
Cost of mining	6,554,231	1,515,044
Cost of milling	2,987,320	740,249
General and administrative expenses	1,015,408	379,877
Interest expense	1,091,567	282,129
Mining taxes	655,000	13,000
	12,303,526	2,930,299
INCOME BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	5,267,011	257,815
Income taxes — deferred, less investment tax credit and savings from earned depletion claims of $550,000 in 1977 and $55,000 in 1976	1,198,500	45,000
INCOME BEFORE CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	4,068,511	212,815
Cumulative effect on prior year of change in method of accounting for broken ore, less applicable deferred income taxes of $66,500 — Note D	123,500	—
NET INCOME — Note B	4,192,011	212,815
Retained earnings at beginning of period	212,815	—
RETAINED EARNINGS AT END OF PERIOD	$ 4,404,826	$ 212,815
Pro forma net income — Note D	$ 4,068,511	$ 336,315

See notes to financial statements

AUDITORS' REPORT

Shareholders and Board of Directors, Madawaska Mines Limited, Bancroft, Ontario

We have examined the statements of financial position of Madawaska Mines Limited as of December 31, 1977 and 1976, and the related statements of changes in financial position for the years then ended, and the statements of earnings and retained earnings for the year ended December 31, 1977 and the four months ended December 31, 1976. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note B to the financial statements, concentrate sales revenues include an amount which has not yet been accepted by the Company's principal customer.

As discussed in Note C to the financial statements, the Company recovers the costs of deferred charges over the life of the ore reserves. At present, there may not be sufficient economically recoverable ore reserves to amortize these costs and, therefore, the recovery of these costs is deemed uncertain at this time.

In our opinion, subject to the acceptance of the sales price of concentrate sales and subject to the realization of the costs of deferred charges as explained in the two preceding paragraphs, the financial statements referred to above present fairly the financial position of Madawaska Mines Limited at December 31, 1977 and 1976, the changes in its financial position for the years then ended, and the results of its operations for the year ended December 31, 1977, and the four months ended December 31, 1976, in conformity with generally accepted accounting principles which, except for the change, with which we concur, in the method of accounting for broken ore as discussed in Note D, have been applied on a consistent basis.

Toronto, Ontario
February 17, 1978

ERNST & ERNST
Chartered Accountants

NOTES TO FINANCIAL STATEMENTS

NOTE A — SUMMARY OF ACCOUNTING POLICIES

Inventories: Broken ore and concentrate in process inventories are carried at cost (first-in, first-out method) and are not in excess of market values. Material and supplies inventories are valued using the average cost method.

Property, Plant, and Equipment: Property, plant, and equipment are stated at cost to the Company. Depreciation of plant and equipment is computed on the straight-line method over the estimated useful lives of the respective assets.

Deferred Income Taxes: Deferred income taxes arise principally from timing differences in expensing certain capital costs for tax purposes at rates in excess of amortization, depletion, and depreciation for financial statement purposes. The investment tax credit is recognized on the flow-through method.

Consolidated Subsidiary: The Company is a 51% owned consolidated subsidiary of Federal Resources Corporation, and is 49% owned by Consolidated Canadian Faraday Limited.

Major Customers: The Company had two major customers during the year. Eighty-five percent of total sales were made to one customer and fifteen percent to the other.

Pension Plan: The Company initiated a pension plan in 1977 for its employees which is funded by both the salaried employees and the Company. The hourly employees are included in the plan as of January 1, 1978. The actuarially computed value of benefits has been fully funded.

NOTE B — SALES PRICE

Sales revenues from the Company's principal customer are based upon a sales price for 1977 uranium, at $42.00 per pound, less a commercial discount of 5% for a net price of $39.90 per pound consistent with Company's belief that the same constitutes the proper contract price. The Company's principal customer disputes this price and is currently making payments based on a net price of $30.59 per pound. The Atomic Energy Control Board of Canada has advised the company and its customer that an export license for 1977 uranium production will not be issued at a price less than $42.00 per pound. A dispute is pending in the Federal Court of Canada, wherein the customer seeks a declaration that the decision of the Atomic Energy Control Board of Canada is unlawful.

Should the decision of the Federal Court of Canada be favorable to the Company, the Company believes it will have no difficulty in obtaining a price of at least $42.00 per pound from its customer or others. If the decision of the Federal Court of Canada is not favorable to the Company, the disposition of the matter would be uncertain and could require appropriate revision in the accompanying financial information.

NOTE C — DEFERRED CHARGES

At December 31, 1977, the recovery of costs in deferred charges cannot be assured. Costs to be recovered through future sales are as follows:

Organization costs consist of legal and professional charges incurred in the formation of the Company.

A management fee for services provided, less amortization of $46,431 at December 31, 1977, and $13,614 at December 31, 1976, was:

	1977	1976
Federal Resources Corporation	$ 180,320	$ 197,057
Consolidated Canadian Faraday Limited	173,249	189,329
	$ 353,569	$ 386,386

Under the terms of an Agency Agreement dated April 16, 1975, the Company agreed to pay $3,500,000 to its shareholders in consideration of services performed by them in securing a contract for sale of uranium concentrates to an agency of the government of the Republic of Italy. The distribution, less amortization of $429,774 at December 31, 1977, and $144,804 at December 31, 1976, was:

	1977	1976
Federal Resources Corporation	$1,995,647	$2,164,102
Consolidated Canadian Faraday Limited	1,074,579	1,191,094
	$3,070,226	$3,355,196

Costs related to deepening the shaft, creating stations and pockets, and similar development work are being

capitalized. Amortization of these expenses is based on pounds of U_3O_8 in reserve and will be expensed to operations as these pounds are mined and processed.

The Company has also deferred all general and administrative costs prior to September 1976 when commercial operations commenced.

Deferred mine development costs, less amortization of $605,430 in 1977 and $180,696 in 1976, was:

	1977	1976
Expenses incurred in the years 1967 to 1975 by Can-Fed Resources Corporation (a wholly-owned subsidiary of Federal Resources Corporation)	$1,595,734	$1,743,846
Expenses incurred by the Company from April 1975:		
Underground	3,462,199	2,158,102
General	355,219	388,190
Administrative	650,254	710,609
	4,467,672	3,256,901
	$6,063,406	$5,000,747

Company engineers and geologists consider that economically recoverable ore reserves on the property are more than adequate to amortize the capital investments and deferred charges recorded on the Company's books.

NOTE D — CHANGE IN METHOD OF ACCOUNTING FOR BROKEN ORE

During the year the Company changed its method of accounting for broken ore. The Company had not applied any indirect costs (support and service costs) to the broken ore inventory.

The cumulative adjustment of $123,500 (after reduction of deferred income taxes of $66,500) regarding the new method was not applied retroactively but was included in earnings for 1977.

NOTE E — INDEBTEDNESS TO SHAREHOLDERS

Indebtedness to shareholders is as follows:

	Federal Resources Corporation	Consolidated Canadian Faraday Limited	Total
Balance, December 31, 1976	$1,831,712	$1,000,000	$2,831,712
Advanced during 1977	2,167,327	—	2,167,327
Balance, December 31, 1977	$3,999,039	$1,000,000	$4,999,039

The indebtedness outstanding at December 31, 1976 is secured by debentures which are non-interest bearing and will be repayable subject to the priority of the Bank Loan Agreement as set forth in Note F, based on a formula linked to the Company's cash flow.

The amounts of $2,167,327 advanced during 1977 by Federal Resources Corporation are to be secured by debentures bearing interest at a rate of 2% above the rate the Company is paying under the aforementioned Bank Loan Agreement.

In addition Federal Resources Corporation, by an agreement dated October 1, 1977, has agreed to advance a further $832,673 upon request by the Company to meet current operating obligations.

NOTE F — NOTE PAYABLE TO BANK

Under a loan agreement dated July 1, 1975, a Canadian bank granted a $6.1 million term line of credit to finance the rehabilitation of the mill and the development work necessary to put the mine into operation. The loan agreement was signed by both the Company and Federal Resources Corporation.

As security for the outstanding notes payable, the Company has issued to the bank 15% per annum demand debentures dated September 3, 1975, and November 12, 1976, for $13.5 million. These debentures are secured by a fixed and floating charge on all of the assets of the Company, except for certain houses and trailers.

NOTE G — DEFERRED INCOME

The Company has taken over responsibility for the terms of an agreement executed in April 1975 by Federal Resources Corporation and Consolidated Canadian Faraday Limited, to sell up to 26,000,000 pounds of uranium concentrate to an agency of the government of the Republic of Italy.

The contract provided that the customer make prepayments totalling $3,900,000 to be applied, under certain circumstances, to uranium concentrate deliveries. This prepayment was recorded as deferred income when received and is recognized from time to time as revenue in accordance with contract provisions.

STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Year Ended December 31 1977	1976
SOURCE OF FUNDS		
From operations:		
Net income	$ 4,192,011	$ 212,815
Charges to income not requiring current outlay of working capital:		
Depreciation and depletion	749,612	256,985
Amortization of deferred charges	747,824	341,590
Deferred income taxes	1,265,000	45,000
TOTAL FROM OPERATIONS	6,954,447	856,390
Increase in long-term debt	2,313,490	3,746,880
Decrease in deferred charges	—	1,528
	9,267,937	4,604,798
USE OF FUNDS		
Application of prepayment under sales agreement	3,900,000	—
Purchase of property, plant, and equipment	1,632,511	3,285,957
Retirements of long-term debt	1,007,904	—
Increase in deferred mine development costs	1,487,393	2,900,422
	8,027,808	6,186,379
INCREASE (DECREASE) IN WORKING CAPITAL	$ 1,240,129	$ (1,581,581)
CHANGES IN COMPONENTS OF WORKING CAPITAL		
Increase (decrease) in current assets:		
Cash	$ 225,640	$ (128,834)
Accounts receivable	2,514,134	1,747,486
Inventories	1,022,382	755,028
Prepaid assets and other current assets	52,319	(2,742)
	3,814,475	2,370,938
Increase in current liabilities:		
Note payable to bank	300,000	1,850,000
Bank advances	555,849	445,607
Trade accounts payable	324,624	213,845
Accounts payable to Federal Resources Corporation	303,396	61,882
Other payables and accrued liabilities	446,964	361,903
Mining taxes	642,000	13,000
Current portion of long-term debt	1,513	1,006,282
	2,574,346	3,952,519
INCREASE (DECREASE) IN WORKING CAPITAL	$ 1,240,129	$ (1,581,581)

See notes to financial statements

CONSOLIDATED CANADIAN FARADAY LIMITED
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Printed in Canada